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ABSTRACT

Property tax relief for the Illinois taxpayer, predicated on full state funding of elementary education, is advocated in this paper. A consequence of full state funding is the reduction of property taxes for education and creation of an educational income tax. Effects at the elementary level are equity and adequacy; at the secondary level, school and program choice. The discussion places the Illinois tax burden in context, briefly explores the economics of affected educational benefits, and concludes with the concept of full state funding of elementary education and subsidization of secondary education in Illinois public schools. Tables of tax data are included. (10 references) (Author/LMI)

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CUTTING THE GORDIAN KNOT: A PROPOSAL FOR FULL STATE FUNDING OF ELEMENTARY EDUCATION IN ILLINOIS

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This series of monographs is dedicated to Professor Lucy Jen Huang Hickrod, late of the Sociology Department of Illinois State University. Death has forever taken Professor Huang Hickrod from intellectual labors, but she remains an inspiration to her husband, her family and her many friends. *Sic transit Gloria Mundi.*

Abstract

This argument for property tax relief for the Illinois taxpayer is predicated on full-state funding of elementary education. Property taxes for education would be reduced and an educational income tax would be actualized. Equity and adequacy become achievable at the elementary level. Choice of programs and schools at the secondary level becomes possible. The discussion that follows places the Illinois tax burden in context, briefly explores the economics of affected educational benefits, and concludes with the concept of full-state funding of elementary education and subsidization of secondary education in the public schools in Illinois.

Introduction

There is no intent in the following argument to persuade the reader that full-state funding of elementary education is the best solution to the problems of property tax burden and to the problems of equity, adequacy and choice. Rather, the intent is to advance a thesis that will afford policy-makers in Illinois a solution to parity problems in funding and burden--a way to cut the Gordian knot. The context in which the argument is made recognizes political and practical realities in Illinois; and credibility for the argument emanates from the original "Plan" advanced by Guthrie, Garms and Pierce in School Finance and Education Policy. Arguing it again here is a way of putting the matter of property tax relief in the context of one state's fully-funding of elementary schools and subsidizing the programs of low-income students in secondary schools. The thesis has been reintroduced to ameliorate the "climate" in Illinois, which can be characterized as a Gordian knot of principle and practice in the politics of educational finance.

Since 1985, individuals with the interests of Illinois' school-aged children at heart have tried to reform the school grant-in-aid system by devising a resource equalizing formula that will have broadly-accepted adequacy and equity attributes. The reform efforts have resulted in two versions of the resource equalizer/guaranteed-tax-base model, both of which reduced district disparities. However, it is unlikely that either model will become law in Illinois because they remove local initiative, to some extent. The gridlock over funding in the state can be overcome and Illinois voters can be accorded property tax relief before a costly California-type Proposition 13 or a court case is initiated in this state.

Tax Relief

Tax relief from effective tax rates that are too high or from tax burdens that are inequitable? Ideally, property tax relief will lessen the amount paid and balance the burden. Lessening the amount imposed reduces taxes paid on property and lowers the amount of tax burden the homeowner incurs on behalf of the schools. Balancing the burden can be achieved by allowing another tax, namely an income tax, to pick up part of the burden for the schools--for example, to use an educational income tax instead of the property tax to fund education for rich and poor alike.

Nonetheless, property tax relief is lower taxes on a person's land and home. It can be accomplished by lowering the assessed value of the property, lowering the effective tax rate on the property, limiting the amount of tax paid on the property, discounting the property value, or rebating some or all of the tax. (Another, albeit unusual, way to provide tax relief is for someone else to provide the money to pay the tax. For example, the Town of Ohio, Illinois, does that for its new homeowners, through a foundation funded with local business contributions. The foundation pays a family an amount equal to three-to-five years of property taxes, as an incentive to relocate and to buy a home in Ohio, IL.)

The only way to permanently lift the property tax burden for Illinois schools is to shift the funding in whole or in part to a tax on income. This might appear to be only "smoke and mirror" relief since the taxpayer still pays, to the department of revenue in Springfield instead of to the local county treasurer. The chief advantage of this shift is that, regardless of where a child happens to attend elementary school in Illinois, the child will receive a uniform, adequate education, prescribed by the state and fully paid for by the state. The high schools would be supported by the local property tax to the extent that each community deems adequate and appropriate. Not all communities will support the same type of high school program, because, presumably, communities will support secondary school programs to meet different social and vocational needs.

Illinois in Context

It is helpful to see a perspective of the State of Illinois and its relation to other states with respect to the taxpayer burden. According to the May 1989 newsletter of the Taxpayers' Federation, Illinois' state and local tax burden per $1,000 of personal income had been moderate. "The [total] burden in Illinois is 8.6 percent lower than the average for the fifty states. Illinois is somewhat higher in property taxes than the averages for the Great Lakes states, the industrial states, and the U.S. states. . . It is significantly lower in income taxes when compared to these three groups. Illinois' low-rate, broad-based state income tax is the key ingredient to [the State's] moderate tax burden and favorable tax climate." The amount of taxes paid per $1,000 of personal income ranked Illinois 33rd among the 50 states. (U.S. average taxes per $1,000 personal income, $114.79; Illinois, $106.15) The per capita tax burden of an Illinois taxpayer ranked the state 17th and dropped it below the national average [U.S. average state and local taxes per person, $1,664.54; Illinois, $1,650.21]. The following table of tax amounts and Illinois' ranking among the 50 states was taken from the Taxpayers' Federation's newsletter. The numbers in parentheses are Illinois' rank among the 50 states.

Personal Income tax		$17.19 (13)
Sales tax		18.91 (13)
Property tax		1.24 (5)
Utility tax		3.26 (3)
Motor Fuel tax	4.11 (10)	
Vehicle License	3.22 (4)	7.33
Corporate Income	4.53 (10)	
Corporate License	.41 (9)	4.94
Other forms of tax		5.06
Total tax per $1,000		$57.93

A COMPARISON OF PROPERTY TAXES IN THE GREAT LAKES REGION FOR THREE FISCAL YEARS

States	Total Tax ($1,000s)	Population (1,000)	Tax Per Capita ($)	Prop Tax/ Total Tax (%)	Rank Among Fifty
		1967			
Illinois	1,118,623	10,958	102.08	66.8	43
Indiana	476,730	5,065	94.12	57.8	32
Michigan	856,007	8,673	98.70	52.6	25
Ohio	1,038,129	10,610	97.84	65.9	40
Wisconsin	460,220	4,211	109.29	66.4	41
		1977			
Illinois	2,241,593	11,434	196.05	55.1	34
Indiana	756,789	5,446	138.96	44.7	23
Michigan	1,848,662	9,202	200.90	49.1	28
Ohio	1,713,250	10,795	158.71	53.0	32
Wisconsin	974,011	4,631	210.32	59.1	41
		1987			
Illinois	3,405,775	11,582	294.06	56.5	42
Indiana	1,316,794	5,531	238.08	37.0	18
Michigan	4,291,557	9,200	466.47	59.3	43
Ohio	2,822,108	10,784	261.69	44.8	27
Wisconsin	2,007,664	4,807	417.65	60.7	45

In the July 1989 issue of the Taxpayers' Federation's newsletter, an analyst wrote, "Four counties [in Illinois] having the highest residential tax burdens also have the lowest percentages of nonresidential properties in their tax bases. This means that growth in property taxes where there is little commercial, industrial, or farm property falls heavily on homeowners. As long as . . . school districts rely heavily on the property tax for their revenues, tax bills will continue to climb upward, and homeowners will . . absorb an ever increasing burden." A followup in the August 1989 newsletter stated: "There is no doubt that Illinois faces serious problems of equity in school funding and overly burdensome real estate taxes."

The effective tax rate on a piece of property is the amount of the taxes expressed as a percent of the market value of the property. A home that would sell for $100,000, with a property tax bill of $2,000 has an effective tax rate of 2 percent. In 1979, 12 percent of the cities in Illinois had an effective property tax rate which was above two percent. In 1987, in 49 out of 58 cities in Illinois the effective property tax rates were above two percent. Effective tax rates in some areas were above three percent, which, by the way, was the threshold for Proposition 13 in California. Twelve cities had rates above three percent, and one city had an effective tax rate of almost 4.4 percent. For example, in East St. Louis, a person owning a piece of property valued at $50,000 where the effective tax rate was 4.4 percent paid approximately $2,191 in taxes. A property owner in Northbrook where the effective tax rate was 1.275%, paid $638 on a home valued at $50,000. If property assessment were a perfect science, the effective tax rate would be the same as the "billed" rate and all property would be taxed at exactly the same proportion of market value. Obviously, assessing practices are not an exact science and effective tax rates vary.

Tax rates have been lowered by homestead exemptions. A home with a market value of $100,000 and an assessed value of $33,333 (33%), would be lowered by $3,500 with a homestead exemption to $29,833 (29.833% of market value). If the tax rate were 6.00%, the effective tax rate would decline from 2 percent (6% x $33,333 = $2,000; and $2,000/$100,000 = 2%) to 1.79 percent (6% x $29,833/$100,000). This lowers the tax bill from $2,000 to $1,790.

A uniform statewide tax rate has been proposed in two models that were considered by the Illinois General Assembly. Ostensibly they would have provided relief for taxpayers in districts where the operating tax rate was above the proposed statewide rate. However, if the educational operating tax rate is high and the effective tax rate is not, taxpayers would receive some relief when, in fact, their effective rate did not warrant that relief. Taxpayers would not see any relief where the tax rate is close to the proposed statewide tax rate even if their effective rate were high. The following numbers from two actual homes illustrate this "glitch" in the prototype funding models that were proposed:

> House A with market value at $320,000 and taxes at $5,400 has an effective tax rate that is 1.6875% (5400/320000).
>
> House B with market value at $92,000 and taxes at $1,900 has an effective tax rate that is 2.0652% (1900/92000).
>
> The local school operating tax rates for these two homes were 5.90% and 3.65%, respectively. The statewide tax rate for the prototypes was 3.50%.

The taxpayer in House A was to receive tax relief of approximately $2,196 (5.90% reduced to 3.50%, or 2.40%; 2.40% divided by 5.90% times $5,400 equals $2,196) The House B taxpayer was to receive a tax reduction of approximately $78 (3.65-3.50 = .15; .15/3.65x1900 = 78).

If the proposed rate were imposed, the effective tax rates would have been 1% for House A and 2% for House B.

This odd outcome of the well-intentioned prototype would lead some to the conclusion that, "The general property tax ... is beyond all doubt one of the worst taxes ... it imposes double taxation on one man and grants [almost] entire immunity to the next" (Webb, et al). The effective tax rate is the only way to get a handle on the parity problem; it also twists the Gordian knot of confusion even tigher.

Recently, the Illinois income tax was raised to 3% and homeowners were given an additional property tax deduction on their state income tax. The deduction was welcomed, but it was not relief from property tax; taxpayers will pay the same property tax. They may pay less income tax (if their income stays the same). A political gambit was employed to make the income tax increase less objectionable.

Trade-Offs and Benefits

Property tax relief is a complicated policy formulation process. Consequences can bite one in the backside if attempts at it are ill conceived. Should educational efficiency and reduced costs be the means by which tax relief can be accomplished? Are trading-off educational benefits or finding other sources of revenue more acceptable or more agreeable means for providing relief for the homeowner and taxpayer?

First, consider the benefits, direct and indirect, that education provides--the return-on-investment, so to speak. Education is the process by which the knowledge and skills and cultural values of society are passed on from generation to generation. Education increases productivity and economic growth. Society will invest in education up to the point where investing in something else pays bigger dividends--a rate of return. The rate-of-return to an individual for having had an elementary education is approximately 100%; for society, in general, it is 15%. The rate-of-return for a secondary education is 16% for the individual and 13% for society. Obviously, education pays exceptional dividends on the property tax investment. Education broadens employment possibilities and increases the likelihood that workers will remain employed. Educated individuals perform more independently, make better use of leisure time, are informed consumers, and manage their personal assets better. Education is related to wellness and longer life. In short, there are benefits for the individual, for communities and for society, in general. The rate-of-return at the elementary level is substantial enough to have broad appeal. At the secondary level, the rate-of-return has specific value to the individual and to the community.

Nearly everyone has an opinion about whether schools are efficient. (MacArthur/Spencer monograph #11 deals with this subject and more empirical studies on the topic are under way as part of that series.) Considering the payoff of investment in education, it appears that the money is exchanged for value that does not depreciate and that provides lifelong benefits. Since the amounts that are invested at the elementary level are returned 100%, schools at that level are good investments! Through the efforts of teachers and administrators, the most-education-for-the-buck is being achieved, more often than not. There are two areas where the efficiency of investment

could be enhanced: in technology and in staffing. Technology could increase the impact of specialists and experts in all fields of education through interactive television, communication, computers, etc. Technology would retain rural and sparsely-populated schools as viable educational systems.

Differentiated staffing and variations in class size in schools are further areas where additional efficiencies could be achieved. In differentiated staffing, teachers with unique skills and disciplines perform in extended capacities: in large-group teaching, in mentoring new and less experienced teachers, and in curriculum development. Teachers serve the educational programs in ways that take advantage of their skills, level of development and abilities. Differentiated staffing delivers the program in an organizational framework which is different from the one that is the norm now; a framework that could be more efficient through increased class size in appropriate disciplines, and cost less. In order for lasting efficiencies and increased productivity to materialize in restructured organizations and teaching systems, the individuals involved must be afforded participation in the policy deliberations that ultimately determine the environoment of their work.

Increased class size has the potential of lowering costs and, subsequently, the burden of support borne by the taxpayer. Increasing class sizes across the board has already occurred as a result of negotiated salary and benefits increases. As teachers' salaries and benefits have risen, positions were cut to create "new" money for salary increases. A more rational approach to achieve efficiencies-through-cost-reduction is through differentiated staffing. Assigning more students to some teachers, lessening their ancillary workloads, and devising organizational methods that would enable other teachers at various developmental levels to contribute are better ways to achieve cost efficiency than are generalized cuts in staff. Very likely, future research in Illinois may show that "optimum" class sizes are too high in some locations and too low in other locations. That is, there may well be no single "optimum" class size.

Change in Support

A wise friend in government once asked me, "What will happen if this proposed policy initiative is not implemented?" I have found it a good practice to ask myself that question from time to time in developing arguments such as this. My answer is that the consequences are either a taxpayer backlash, like Proposition 13 in California, or costly litigation like the Kentucky and Texas cases, or both.

Switching the source of support for education from the property tax to the income tax would shift the burden more to the individual taxpayer. Currently, this is the incidence of burden between individuals and corporations for the property and income taxes:

	Individual	Corporation
Property Tax	55%	45%
Income Tax	83%	17%

This fact has not been lost on business organizations in Illinois.

If the revenue were equal to the appropriations for education, a special statewide income tax for education would require a tax of about 2% on the income base. The businesses could and, undoubtedly, would escape the impact by shifting the incidence to the consumer, including consumers in other states. It would be necessary to limit the deducations taken by a business to reduce its tax liability.

Utilizing the most current available data, this shift would look roughly like this:

Cost for Elementary Education	$4,006,784,739
General State-aid Appropriation (GSA)	2,650,000,000
Additional GSA from Income Tax	1,346,784,739
Approximate increase in support	50%
Cost for High School Education	$2,648,263,652
Property Tax Revenue	3,905,267,404
Property Tax Relief	- 1,257,003,752
Approximate decrease in support	32%

Individual income tax would rise from 3% to 3.9%. Corporate income tax would rise from 4.8% to 6.3%.

To support just the elementary schools would require an educational tax rate of less than 2%. Three-fourths of Illinois' students are educated in the elementary schools, at about two-thirds of the cost of the average Illinois high school student. Individuals and corporations would pay a property tax and an income tax for education. The property tax would support the secondary program and the income tax would support the elementary program, and subsidize the secondary program through grants to families where the desired high school program proved to be appropriate but not affordable. The property wealth per pupil is the major disequalizing factor, as it always has been. Even in a plan that realigns educational policy and tax burden there still remains the problem of raising sufficient revenue in some communities for adequate and desirable educational programs.

Districts will want dollar-for-dollar exchange for the lost property tax and the replacment grant-in-aid. Any change or shift in reliance on a revenue source must result in a predictable, continual and fair level of school funding. Since there has been a growing dependence on funding that shifts the cost of current operations from current revenue to long-term bonded debt, the need for a swift change is essential.

The "Golden Rule" states "He who has the gold, rules." Full state funding of elementary schools might mean more policy decisions from Springfield. There might be less incentive for efficiencies at the local level, as a consequence of loss of local involvement and control over policy.

Under a system of full-state support of elementary education, some, but not all, of the property tax burden would be lifted from the taxpayers in all Illinois school districts. The state would fully fund the elementary schools and partially fund the high schools. The local taxpayers would not supplement the cost of operating the elementary school program. The state would assume that financial burden and would prescribe the total program at the elementary level. The state might have to fund a more costly statewide

program than is the case now because the objective would be "to raise all the ships in the bay," to increase all elementary programs that are below the median. The state's contribution would scale back at the secondary level and local property taxes would step in to support the secondary programs, and local boards would prescribe the secondary educational policies. Policy-making would be commensurate with the level of support: state policy would equalize the elementary programs and, apart from a basic or minimally adequate high school program, local policy would determine the funding at that level.

The burden of support shifts. The state corporate and individual income tax for education increases to a level that puts Illinois on a par taxwise with it neighbors. The model has the potential of placing Illinois in a more advantageous position educationally than its neighbors. Without complete simulation of the model it is difficult to determine exactly how the financial parameters would be affected. It would appear from preliminary estimates that the property tax relief would be about ten percent and the income tax increase would be below the aforementioned educational income tax of two percent. The ball park figure of a total 4.5 percent personal income tax is certainly adequate to do the job and such a level would not put Illinois' tax rate ahead of other states. This same figure has been mentioned as the "target" level in several other recent fiscal policy proposals for Illinois. Whether or not it can be achieved by legislative action alone or whether it will take both litigation and legislation are open questions.

Elementary education forms values and basic skills that become the fabric and texture of society and culture for individuals. If fully-funded, state policy would shape programs at the elementary level; and, it can be argued, that it should shape these program because the greatest amount of social benefits are derived from elementary education. If fully-funded at the local level, the secondary educational program would shape vocational, professional, and social interests that reflect local needs. Not the least of the "selling points" of this model is that it retains a "market mechanism" at the secondary level with considerable local choice, but removes local choice at the elementary level in order to achieve equity and adequacy goals.

This model addresses the existing dual district structure in Illinois and could easily accommodate the unit district structure. Unit districts may not be felicitous educational organizations nor even be economically efficient. Illinois might want to encourage larger high school districts and, in some cases, smaller, more homogeneous elementary districts--in other words, dual districts instead of unit districts.

This concept of full-funding for elementary programs in Illinois probably would have to be phased in with a continuation of the income tax surcharge to determine if the program is workable. Whether it achieves the desirable academic policy objectives and taxpayer equity that this argument has adopted as basic principles is the paramount question. It is possible to conceive of a model that offers "almost full-state assumption" at the elementary level and continues partnership funding at the secondary level. Various computer simulations suggest various percentages of funding by the state. For example, one might want to try 51% state support at the secondary level and 81% state support at the elementary level. This model would not achieve strict equity goals at the elementary level because wealthier elementary districts would continue to raise more from local sources than would poor elementary districts. However, at 80%, state support would be more equitable than that which presently exists. There is no doubt that allowing some local "enrichment" would make the proposal more attractive to General Assembly representatives from the wealthier elementary districts and would likely provide a smoother path for this proposal from concept to enactment into law.

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